1 May 2012

Westpac Institutional Bank

Holding steady

2012 Q1 Labour Cost Index and Quarterly Employment Survey

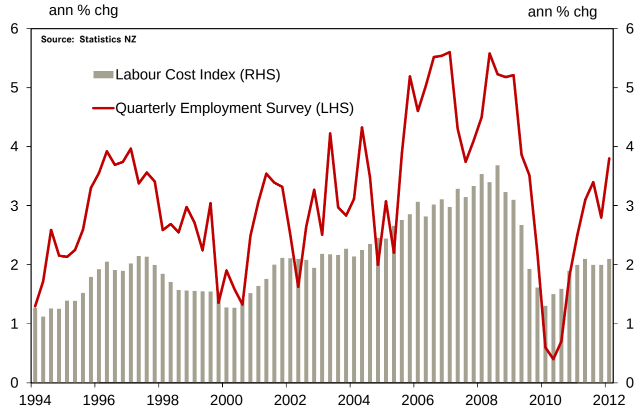
- **Wage growth was subdued, in line with our and the RBNZ's expectations.**
- **Wage inflation in the construction sector continues to outstrip other sectors, but isn't yet accelerating especially rapidly.**
- **The Quarterly Employment Survey's weak jobs print suggests mild downside risk to our forecast for 0.5% employment growth.**

Summary

Today's Labour Cost Index (LCI) report came in pretty much in line with both our and other economists' expectations. It was also consistent with the RBNZ's assessment of wage inflation, albeit a touch lower than the RBNZ was forecasting in its March *Monetary Policy Statement*. This data rounds out a suite of indicators that show inflation in New Zealand is subdued, and further confirms the notion that the RBNZ will not hike the OCR before 2013.

Unsurprisingly given the needs arising from the Canterbury rebuild, as well as a broader pickup in the housing market, there were pockets of above-average wage inflation in the construction sector, professional and technical services, and real estate. Equally unsurprisingly, overall wage pressures are being held down by public sector cutbacks, as well as continued softness in some domestically-focused parts of the economy, such as retail. But that split has been there for a while now. Based on today's data, there's no sign yet that labour market pressures in the construction and related sectors are accelerating to an alarming degree.

NZ LCI and QES wages (private sector ordinary time)



The Quarterly Employment Survey's (QES) hours paid and jobs figures were weaker than both we and the market expected. As such they present some downside risk to our picks for 0.5% employment growth in Thursday's Household Labour Force Survey. But this risk is fairly mild given the historical performance of the QES. Our forecast for unemployment at 6.2% is unchanged

Wages

The Labour Cost Index (private sector, all salary and wage rates - the Reserve Bank's preferred measure) rose 0.5% in the March quarter, and was 2.1% higher than a year ago. This is close to historical averages for both annual wage inflation and for the March quarter print (the LCI isn't seasonally adjusted). Wage inflation has been gradually drifting up from its early 2010 lows as the economy has emerged from recession, but at a fairly sedate pace.

Table: LCI and QES Summary

	Labour Cost Index				Quarterly Employment Survey			
	Dec-11		Mar-12		Dec-11		Mar-12	
	qtrly	annual	qtrly	annual	qtrly	annual	qtrly	annual
Private Sector (ordinary time)	0.7	2.0	0.5	2.1	0.0	2.8	1.3	3.8
Public Sector (ordinary time)	0.4	1.8	0.4	1.6	0.9	3.4	2.8	3.9
Total (ordinary time)	0.6	2.0	0.4	2.0	0.1	2.8	1.4	3.8
FTEs (s.a.)	–	–	–	–	0.5	2.2	0.1	1.1
Filled jobs (s.a.)					0.4	1.9	0.0	1.2
Paid Hours (s.a.)	–	–	–	–	0.5	1.9	-0.5	0.7

Source: Statistics NZ

The distribution and size of wage increases were unchanged from December, with 57% of those surveyed seeing wages increase over the past year, and the median increase remaining at 3%. There are some signs of movement at the upper end of the wage distribution – the average wage increase (as opposed to the median) has gradually drifted up over the past year, from 3.1% to 3.6%. Over that time there has also been a gradual increase in the proportion of people awarded wage increases of between 3% and 5%, from 15% to 18%. However, this is still well below the 25% or more reporting those kinds of wage increases in the years before 2008.

The Quarterly Employment Survey's annual hourly earnings measure was stronger than expected, rising 1.3% for the quarter (our pick was 0.7%, which is much closer to the historical average for the quarter). However, this may be payback from December's weak outturn. More generally we don't regard this measure as particularly meaningful, as it's more volatile than the LCI and doesn't control for changes in job mix or productivity gains. (It's partly because the QES wage measure isn't adjusted for things like promotions that it shows annual wage inflation running at well above 3%.)

Employment and hours

The Quarterly Employment Survey also includes measures of jobs and hours paid, which can be informative in advance of Thursday's Household Labour Force Survey (HLFS). Both were weaker than we were expecting, with full-time equivalent (FTE) employment rising just 0.1% (versus our expectation for a 0.5% increase in HLFS employment) and hours paid falling 0.5% (we were picking a mild 0.8% rise in HLFS hours worked).

However, the jobs and hours measures from the two surveys don't always track each other particularly well, and today's surprises suggest only mild downside risk to our labour market forecasts. Moreover they have little implication for our unemployment forecast (based on evidence from business surveys we expect the unemployment rate to stay fairly flat at 6.2%). Surprises in employment tend to coincide with offsetting suprises in labour force participation, with a broadly neutral effect on the unemployment rate.

Regional and sectoral breakdown

Consistent with a lift in the housing market and a Canterbury rebuild in its early stages, industries seeing above average wage increases over the past year include construction (up 2.3% including overtime), professional and technical services (up 2.8% over a year ago), finance and insurance (up 2.7%), real estate services (up 2.3%), and parts of the manufacturing sector. Statistics New Zealand continues to report above-average wage increases for the Christchurch construction sector in particular. In Christchurch, 62% of construction sector wages increased over the year to December (compared to 51% for NZ overall) and the average construction sector wage increase was 7% (as opposed to 4.7% nationwide).

By contrast, wage inflation remains below 2% in sectors such as health care, education, retail trade and accommodation, reflecting that much of the domestic economy is still very subdued. In stark contrast to the period before the 2008-9 recession, wage inflation continues to be relatively low in the public sector, which has seen labour costs rise just 1.6% over the past year (including overtime).

It's worth noting, though, that we're not yet seeing strong upward momentum in wage inflation in either the construction or real estate sectors. For example, in real estate, annual wage inflation was 2.3%, compared to 2.4% in June last year. Somewhat surprisingly, the Quarterly Employment Survey's jobs breakdown also showed FTE employment falling in both construction and real estate (on our seasonally adjusted measures), after strong increases late last year. Overall jobs growth in Canterbury also remains subdued, with FTE employment in the region falling 0.9% (seasonally adjusted).

Market reaction

An unsurprising wage outturn saw no market response.

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